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STATEMENT OF

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115082

BEFORE THE

SUBCOMMITTEE ON INTERNATIONAL TRADE, INVESTMENT
AND MONETARY POLICY

HOUSE COMMITTEE ON BANKING, FINANCE AND URBAN AFFAIRS

ON THE

[FINANCIAL CONDITION OF ~~THE~~ U.S. EXPORT-IMPORT BANK]

Mr. Chairman and Members of the Subcommittee:

We are pleased to be here today to share with you our concerns about the financial condition of the Export-Import Bank. We annually audit the Bank's financial statements pursuant to the Government Corporation Control Act and recently completed the fiscal year 1980 audit. In the last few years, we also have reported on various aspects of Bank lending. On April 30, 1980, for example, we issued a report on Eximbank's competitiveness. 1/ We currently are reviewing Eximbank's lending policies and practices at the request of Senator William Proxmire. Our testimony today largely will concern issues discussed in our financial audit report, but there are some related matters we would also like to mention.

1/ Financial and Other Constraints Prevent Eximbank From Consistently Offering Competitive Financing for U.S. Exports (ID-80-16).

RESULTS OF OUR
FINANCIAL AUDIT

In our April 8, 1981, letter to Eximbank's Board of Directors, we expressed reservations concerning the adequacy of the reserve for contingencies and defaults because

- the reserve increased but the risk of incurring possible future losses increased to a larger extent,
- reserve adequacy cannot be realistically assessed because of the uncertain nature of future foreign economic and political conditions,
- the Bank's current borrowing rates are higher than its lending rates and the gap between its average cost of borrowed funds and interest earned on loans is widening, and
- the difference between the Bank's borrowing and lending rates may be further aggravated as a result of an agreement between the Bank and the Private Export Funding Corporation (PEFCO) concerning the funding of certain loans.

In a 1975 report, 1/ we said that additions to the reserve were not keeping pace with the growth of the Bank's outstanding commitments. What was true in 1975 is true today. Between fiscal years 1975 and 1980, the reserve increased from \$1.6 billion to \$2.2 billion, or by 35 percent (5 percent between

1/ Weakened Financial Condition of the Export-Import Bank, Oct. 17, 1975, (ID-76-17).

fiscal years 1979 and 1980). In contrast, outstanding commitments increased from \$13.1 billion to \$19.9 billion, or by 51 percent (18 percent between fiscal years 1979 and 1980). Outstanding commitments consist of loans, guarantees, and insurance. The Bank's outstanding commitments are now more than 9 times larger than the amount in the reserve. We are concerned that this gap continues to widen.

We are particularly concerned about the growth, in relation to income, of loan purchases and principal and interest delinquencies.

Loan purchases occur when a borrower defaults on a loan and Eximbank is obligated to pay a claim under a guarantee agreement with a commercial bank. The amount of loan purchases increased from \$62.4 million to \$90.4 million, or by 45 percent, between fiscal years 1979 and 1980.

Principal and interest delinquencies occur when an installment on an Eximbank loan is past due 90 days or more. The amount of delinquencies increased by 165 percent, to \$494 million at September 30, 1980, from the previous year; loans to Iran accounted for this increase. Capitalized interest on delinquent rescheduled loans also jumped from \$19.6 million to \$105.1 million during fiscal year 1980. Total earned but uncollected interest on delinquent loans included in Eximbank's reserve at September 30, 1980, was \$165 million.

Associated with the widening gap between additions to the reserve and outstanding commitments, is another trend which has serious implications for the Bank's financial condition. This is not being able to maintain an adequate interest rate spread

between current lending and borrowing. The Bank estimates that it needs to charge between one-quarter and one-half percent above its average cost of borrowed funds to cover its administrative costs and provide an adequate reserve for defaults. This desired spread is far from being realized. The average cost of the Bank's debt exceeded the rate earned on all outstanding loans by 0.7 percent at the end of fiscal year 1978; by 1.1 percent at the end of fiscal year 1979; and by about 1.7 percent at the end of fiscal year 1980.

In our April 8, 1981, letter to the Bank's Board of Directors, we said that "If this trend continues, the Bank could be in a loss position by fiscal year 1982. Based on [Eximbank] data we obtained subsequent to the balance sheet date, the [interest] differential had increased and the reserve could be exhausted within 7 to 8 years." As of the end of March 1981, the differential had increased to 2.35 percent. The effect of this increasing negative spread has been to significantly reduce the Bank's profitability. Its net income for the first 6 months of fiscal year 1981 was down 57 percent, to \$25.1 million from \$58.0 million, for the same period in fiscal year 1980.

The widening gap between the reserve and the Bank's outstanding commitments also has been affected by an arrangement with PEFCO, a Government-sponsored commercial corporation which raises funds for export financing in the private market using unconditional Eximbank guarantees. Eximbank's relationship with PEFCO is not new, but in September 1980 the Bank agreed to support \$1,099 million in loans for which it will incur substantial increased costs.

Although Eximbank guarantees normally do not require the Bank to make a financial outlay unless a borrower defaults, the September arrangement is unique because the Bank has agreed to reimburse PEFCO for the difference between the latter's interest charges and the rates at which the loans were committed. By agreeing to meet any shortfall between the borrower's interest payments and PEFCO's interest charges, Eximbank in effect used its guarantee authority the same way as it uses direct credit authority, with attendant budget implications. That is, the financial effect to the Bank is fundamentally the same as if it had made the loan directly instead of merely guaranteeing repayment of the loan by the borrower.

[The increased cost incurred through use of this guarantee mechanism cannot be determined until the loans are disbursed, but it may well amount to hundreds of millions of dollars.] This cost can be viewed as consisting of two parts: (1) what it would have cost Eximbank to make the loans directly, since what Eximbank did was tantamount to making the loans directly, and (2) the added cost of financing the loans through PEFCO. The first part is measured as the difference between what it would cost Eximbank to fund the loans through its normal financing facility, the Federal Financing Bank, at the time they are disbursed and the 9 percent rate at which they were guaranteed by Eximbank. Based on recent borrowings from the Federal Financing Bank at 13 percent, this cost would be about \$264 million. Moreover, the arrangement places an additional cost on Eximbank because [PEFCO's usual average interest charges on loans exceed Eximbank's financing rates

through the Federal Financing Bank for equivalent maturities by approximately three-quarters of one percent. Because Eximbank will pay these charges, we estimate that Eximbank's additional cost of funding the loans through PEFCO will be about \$50 million.

Usually, Eximbank's financial guarantees protect PEFCO and other private lenders by assuring repayment of loans in the event of default by the foreign buyer or bank to whom the credit was extended. Although guarantees normally do not require an Eximbank outlay unless the borrower defaults, the September 1980 arrangement was unique in the sense that it placed substantial financial burdens on the bank regardless of whether borrowers default. In our opinion, such burdens represent questionable use of financial guarantee authority and should be avoided in future financing arrangements.

DILEMMA BETWEEN BANK'S SELF-SUPPORTING AND COMPETITIVENESS OBJECTIVES

Although we believe that Eximbank's reserve is subject to impairment, we are also mindful that the Bank is faced with what is by now a familiar, but nevertheless difficult, dilemma. As you know, the Bank is admonished by law to meet the competition, and it has attempted to do so while operating on a self-supporting basis. From 1934 through 1966, it was able to charge more for loans than they cost. Earnings were partly paid to Treasury in the form of dividends of \$1.05 billion while the Bank amassed a reserve of \$2.2 billion. Although the Bank generally has had a negative spread between the average interest rate on its loan portfolio and the average rate on outstanding debt since 1966, it has managed to

continue to show a profit through 1980 because of interest earned on loans financed by its reserve (currently \$2.2 billion) and \$1 billion of initial capital on which it pays no interest. The Bank's self-sufficiency, however, is now being jeopardized by continued concessionary lending in the face of historically high interest rates and repeated inability to successfully negotiate changes to the international arrangement on export credits.

Eximbank's recent practice has been to extend maturity terms on a few loans in order to meet the competition and to demonstrate to its competitors that the U.S. Government is serious about wanting to reduce the subsidy element in export financing. An alternative strategy would be to match the very low interest rates of some foreign financing offers. This strategy was tried several years ago, but was abandoned for budgetary reasons.

Aside from the issue of whether directly subsidizing export financing is a prudent use of public funds, consistently matching the export credit offers of other governments--especially their so-called foreign aid or mixed credit-type loans--is a costly undertaking in a period of high borrowing costs. Increased borrowings or appropriated funds would likely be needed if the Bank's current financial condition continues to deteriorate over the next several years. Whether the now stalled international negotiations on limiting export credit subsidies can be brought to an "acceptable" conclusion is of course unknown; but one fact is incontestable, Eximbank cannot continue indefinitely to borrow at rates which exceed its lending rates by several percent and remain self-sustaining.

In our April 1980 report on Eximbank competitiveness, we suggested several alternatives regarding possible congressional involvement in determining future Bank lending. I won't repeat them here, other than to say in essence that, [when circumstances make the Bank's basic objectives simultaneously unattainable, Congress should either direct Eximbank to emphasize

--its statutory mandate to be competitive over its long standing and congressionally accepted policy of being self-sustaining, or

--this implied mandate to be self-sustaining over its statutory requirement to be competitive.]

[We believe that Eximbank's current financial situation has reached the point where Congress needs to clarify its intent. If the mandate to meet the competition is given predominance over self-sufficiency, some form of subsidy of the Bank's lending activity could be necessary.] It is in this context, Mr. Chairman, that we interpret the intent of your recently introduced House Concurrent Resolution 95. If Congress does not intend that meeting the competition be given predominance in the current situation, then it should affirm that fact by indicating what it believes to be acceptable lending policy. In any event, it is now clear that increased congressional involvement is needed in determining Eximbank's export-financing policies.

This concludes my prepared statement. We will be happy to answer any questions you might have.